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MEETING DATE
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AGENDA ITEM
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January 5, 2011

Ms. Marilyn Leedom
Chief Executive Officer
Contra Costa County Employees' Retirement Association
1355 Willow Way, Suite 221
Concord, CA 94520

**Re: Contra Costa County Employees' Retirement Association
Impact on Future Actuarial Valuations of Changes in Pay Items that are Considered "Compensation" for Retirement Purposes**

Dear Marilyn:

As requested, we are providing information on our recommendations as to how changes in pay items that are considered retirement "Compensation" for new members would be reflected in future actuarial valuations. Note that for purposes of this letter and the annual actuarial valuation we use "terminal pay" as a broad term that includes such items as vacation sellbacks, administrative leave sellbacks and terminal pay items during the final average pay period.

Background

In 1997 the Board adopted a policy that determined which pay items are considered compensation for retirement purposes. Under that policy, various types of terminal pay were included in the determination of compensation for retirement purposes. This policy still applies to members with membership dates before January 1, 2011.

In March 2010, the Board adopted a change to this policy for members with membership dates on or after January 1, 2011. Under this amended policy, certain terminal pay elements are no longer included in the determination of compensation for retirement purposes. Examples of the terminal pay elements that are no longer included are as follows:

a. For each year of the final compensation period, leave amounts sold back during any twelve-month period that were accrued over two or more fiscal or calendar years, and that exceed the amount that was both earned and cashable during service in that twelve-month period.

b. Incentives, bonuses and other payments to the extent they may not be received in cash during service, but only upon termination or retirement.

c. Conversion of in-kind benefits and other advantages to cash during the final compensation period.

Current Terminal Pay Assumptions

The contribution rates determined in the actuarial valuation reflect the anticipated impact that terminal pay will have on expected future benefit payments. The current assumptions for terminal pay (as a percentage of final average pay excluding such terminal pay) are as follows:

General Tier 1:	12.00%
General Tier 2:	3.50%
General Tier 3:	7.50%
Safety Tier A:	11.25%
Safety Tier C:	3.75%

For determining the cost of the basic benefit (i.e. non-COLA component), the cost of this pay element is currently recognized in the valuation as an employer only cost and does not affect member contribution rates.

Note that the member Basic contribution rate is not affected by the terminal pay assumption and there is only a relatively small Cost-of-Living (COL) component for members. As a result, the great majority of the contribution rate impact of the terminal pay assumption is borne by the employer.

It is important to note that the amended Board policy reduces but does not eliminate the inclusion of terminal pay in compensation earnable anticipated above. This means that the Board action will not reduce the terminal pay assumptions by the full amounts shown above.

Recommendation for Reflecting Changes in Terminal Pay in Future Actuarial Valuations

Since the December 31, 2009 actuarial valuation only included members with membership dates before January 1, 2010, it was not necessary to reflect any possible change to the terminal pay assumption since none of those current members would be affected. The same would hold true for the December 31, 2010 valuation that we will be completing in 2011. However, there are members with membership dates after January 1, 2011 for which member and employer contributions are currently being collected.

Since the level of terminal pay for members with membership dates on or after January 1, 2011 will be lower based on the amended Board policy, it is at least theoretically possible that a separate terminal pay assumption could be developed for these new members. This would result in different employer contribution rates and could result in minimally different member contribution rates for these new members as compared to members with membership dates before January 1, 2011. Ultimately this could result in twice as many separate employer and member rates as are currently in effect.

We recommend not making any adjustment to the terminal pay assumption for new members until the December 31, 2012 experience study at the earliest. This is based on the following reasons:

- It is not known how much the amended Board policy will lower terminal pay for new members as compared to current members. The actual impact will not be known until new members retire many years in the future. Also as noted above the amended policy will reduce but not eliminate the terminal pay assumptions.

- For members, the <u>maximum</u> impact on contribution rates would be only a relatively small amount.

One possibility is to try to track terminal pay information on a prospective basis for future retirees as if it was determined under the amended Board policy, even though in the near future those retirees will still have membership dates before January 1, 2011. This will allow us to better assess the possible impact of the Board policy for new members at the next experience study. At that time, we can determine whether a new separate terminal pay assumption should be applied to new members or if another method to handle this would be more practical given the magnitude of the actual impact.

Our last recommendation concerns whether to have different employer contribution rates made on behalf of members with membership dates before or after January 1, 2011. While the total employer cost would reflect any new difference in terminal pay, this does not necessarily mean that separate employer contribution rates are needed. We recommend that even if new terminal pay assumptions are developed for new members, we would still only determine one employer contribution rate for each employer that would be contributed on behalf of all employees for that employer. That total employer contribution rate would be determined on a combined basis including both old and new members.

This specific recommendation is based partially on administrative considerations, but is also based on the fact that theoretically the same amount of employer contributions would be collected whether (1) there is one combined rate for each employer that would be applied to compensation for all employees of that employer or (2) there were two rates that would be applied to separate employee populations of that employer.

Please let us know if you have any questions, and we look forward to discussing this with your Board.

Sincerely,

Paul Angelo, FSA, EA, MAAA
Senior Vice President and Actuary

John Monroe, ASA, EA, MAAA
Vice President and Associate Actuary

JZM/gxk